Recommendations

1. Retain North Carolina's Research and Development Tax Credit

North Carolina offers a Research and Development ("R&D") tax credit based on the percentage of qualified research expenses that a business pays or incurs during the year. This credit has been modified by the legislature several times. Recently the General Assembly extended the tax credit, which had been scheduled to expire on January 1, 2009, for five years.

The R&D tax credit was the only investment-based tax credit incentive examined that was correlated with companies adding new jobs both before and after receiving the incentive. Moreover, job quality goals are admirably intrinsic as the credit is premised on companies satisfying several "employment quality" eligibility criteria including wage standards, health insurance, and occupational safety regulatory compliance.

The R&D credit is also distinct from other investment-based tax credits in that it is available to companies regardless of their industry, business type or size. Therefore, corporations, partnerships, and limited liability companies are eligible. This flexibility enhances the prospect of its use by firms in distressed areas and incents (or rewards) innovative corporate strategies that undergird "growth companies" regardless of industry.

North Carolina firms generated $221 million in state R&D tax credits between 2003 and 2008. Retaining the R&D tax credit will cost an estimated $250 million in credits generated and $124 million taken during 2010-2015.

2. Eliminate North Carolina's Statutory Tax Credits (i.e. Article 3J Program)

North Carolina's current economic incentive portfolio is heavily allocated toward the statutory tax credits constituting the William S. Lee Act and the Article 3J program. Of the more than $2 billion in economic incentives committed between 1996 and 2006, 98% of the incentives were in the form of statutory tax credits.

Such tax credits were the basis of North Carolina's original foray into economic incentives. The process which devised what became the William S. Lee Act was a thorough and thoughtful one that drew on the best available information to devise appropriate incentives for the economy of the mid-1990s. In fact the incentives appeared to have succeeded for several years as the companies receiving them outperformed the North Carolina economy throughout the 1990s.

Unfortunately, by the end of that decade companies receiving statutory tax credits no longer outperformed – or even matched - the state's economy. The explanation for this performance decline may be attributable to several factors, including legislative amendments that expanded the number of eligible firms and possibly diluted the net